

CHAPTER 1

ACCOUNTING SYSTEM – ACCOUNTING PROCESSES

SCOPE

This chapter is intended to give a basic understanding of accounting theory and how it is applied within the ENCOMPASS financial accounting system.

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1.1 STATUTORY AUTHORITY

1.1.1 State Board of Accounts

IC 5-11-1-2, **System of accounting and reporting**, states in (a): “The state board of accounts shall formulate, prescribe, and install a system of accounting and reporting in conformity with this chapter, which must comply with the following: (1) Be uniform for every public office and every public account of the same class and contain written standards that an entity that is subject to audit must observe. (2) Exhibit true accounts and detailed statements of funds collected, received, obligated, and expended for or on account of the public for any and every purpose whatever, and by all public officers, employees, or other individuals. (3) Show the receipt, use, and disposition of all public property and the income, if any, derived from the property. (4) Show all sources of public income and the amounts due and received from each source. (5) Show all receipts, vouchers, contracts, obligations, and other documents kept, or that may be required to be kept, to prove the validity of every transaction. The state board of accounts shall formulate or approve all statements and reports necessary for the internal administration of the office to which the statements and reports pertain. The state board of accounts shall approve all reports that are published or that are required to be filed in the office of state examiner. The state board of accounts shall from time to time make and enforce changes in the system and forms of accounting and reporting as necessary to conform to law.”

1.1.2 Auditor of State

IC 4-7-1-2, **Powers and duties**, states: “The auditor of state shall do the following: (1) Keep and state all accounts between the state of Indiana and the United States, any state or territory, or any individual or public officer of this state indebted to the state or entrusted with the collection, disbursement, or management of any money, funds, or interest arising there from, belonging to the state, of every character and description whatsoever, when the money, funds, or interest is derivable from or payable into the state treasury.” And further states in (3): “Keep fair, clear, distinct, and separate accounts of all the revenues and incomes of the state and all expenditures, disbursements, and investments of the state, showing the particulars of every expenditure, disbursement, and investment.”

1.2 ACCOUNTING THEORY

The State of Indiana Comprehensive Annual Financial Report (CAFR), as well as other reports, must be prepared in accordance with Generally Accepted Accounting Principles (GAAP), Financial Accounting Standards Board (FASB) statements, and Governmental Accounting Standards Board (GASB) statements. Currently, since not all ENCOMPASS modules are required, certain State of Indiana financial records are maintained on a cash basis. Adjusting entries are made by the Auditor of State (AOS) staff in order to compile the CAFR. As more ENCOMPASS modules are required, the State will move toward a full accrual system, which will increase the timeliness and accuracy of financial statements.

1.2.1 Definitions of Accounting Financial Statement Classifications

Brief definitions of certain accounting terms are included in this section as an aid to a better understanding of certain entries into ENCOMPASS. As we move toward a full accrual system, updates will include additional explanations as deemed necessary.

- *Asset – the financial value (economic benefit) of what is obtained (owned) or controlled (owed to) by a particular entity (the State of Indiana, in our case). Assets would include, but are not limited to, Cash, Accounts, Grants & Loans Receivable (owed to), Capital Assets (owned). Asset account numbers begin with “1”.*
- *Liability – future sacrifices of Assets; i.e. what is owed and, in all probability, will be paid to outside vendors, other governments, etc. This does not include encumbrances; a liability does not exist until the goods or services have been received. Liability account numbers begin with “2”.*
- *Net Assets – total Assets less total Liabilities; in other words, the net worth of the entity. Net Asset (and fund balance) account numbers begin with a “3”.*
- *Revenue – revenue is created when a receivable is entered. If revenue is received with no prior receivable, the matching entry is Cash. Revenue account numbers begin with a “4”.*
- *Expenditure/Expense – a matching expenditure (governmental fund types) or expense (other fund types) is created at the same time as the related liability. Expenditure/expense account numbers begin with a “5”, except in the case of ID bills from internal service funds, which will begin with “6”.*
- *Other Financing Sources/Uses – transfers, bond proceeds and payments, distributions, and other related items that should not be included as Revenues or Expenditures in governmental fund types. Other Financing Sources/Uses account numbers begin with a “7”.*
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1.2.2 Fund Types

Within a government, funds are classified as Governmental, Proprietary and Fiduciary. Certain other units are established by state statute as Quasi-Agencies.

Governmental funds -- general fund, capital projects funds, debt service funds, permanent funds; monies which may be spent for operating, construction and debt payments. Permanent fund interest, but not principal, may be spent.

Proprietary funds -- internal service funds, enterprise funds -- internal service funds provide an at-cost service to the government; enterprise funds are self supporting and provide service to citizens.

Fiduciary funds -- pension trust, private-purpose trust, agency funds -- monies not belonging to the government, but held in a fiduciary capacity.

Quasi-agencies -- established by statute to provide certain services to the government; these agencies have the option to establish their own operating rules and regulations, subject to approval by

their respective board or commissions. They are not considered as part of the State of Indiana primary government but, in many cases, are component units of the State.

1.2.3 Double entry accounting

The ENCOMPASS financial system utilizes “double entry accounting”. This means that for every Debit (+) entry there is an equal Credit (-) entry. For most transactions, the other side of the entry is automatically made by the system, assuming the correct equivalent entry is made by the user. If you are not familiar with these terms the following T diagram will help you to determine whether a Debit (+) or Credit (-) entry should be entered in the system. Journal Entries (created in the General Ledger) require knowledge of both sides of the transaction.

DEBIT (DR +)	CREDIT (CR -)
Cash in (Increase in Cash)	Cash out (Decrease in Cash)
Asset (Billing of Receivables)	Liabilities (amounts owed)
Increase in Expenses/Expenditures	Increase in Receipts/Revenues
Reduction (refund) of revenue	Reduction (refund) of expenses/expenditures

As you will note from this table, if you are entering a receipt/revenue (4xxxxx), you would record it as a negative number and precede the dollar amount by a minus sign (-). If you are entering an expenditure/expense (5xxxxx), you would record it as a positive number but you would not need to enter a plus sign (+) as this is the default.

1.3 ENCOMPASS FINANCIAL SYSTEM

On September 16, 2009, the State of Indiana implemented a statewide accounting system which was designed to provide a higher level of accountability to Hoosier taxpayers. This system, known as ENCOMPASS (Enterprise Common Processing and Analytics Systems) will pull together financial data from all agencies in a more consistent manner, thus increasing the integrity of information statewide.

1.3.1 ENCOMPASS Chartfield Structure

Definitions of the major chartfields used in the ENCOMPASS financial system are:

- **Business Unit (BU)** -- the principal unit of financial accountability within State government; some large agencies may include several Business Units.
- **Fund** (replaces fund center) -- the primary means within a Business Unit for tracking and relating specific sources and uses of revenues or budget authority. Funds are self balancing sets of

accounting records. Each Business Unit will have at least one fund, however most will have multiple funds, one for each State appropriation, Federal Granting Agency, or other source of spending authority.

- *Account* -- used to classify specific transactions according to the nature of the receipt, expenditure or effect on the financial position of the fund or entity. *Program* -- a classification of an activity according to the purpose or objective of the activity. One initiative, PROBE, supported the identification of these activities and from the resulting report, Program values have been established. Program could be used to track other activities as well.
- *Department* -- signifies the department incurring a cost; relates to HR department values.
- *Locality* -- identifies a geographic location or area.
- *Product* -- used to track costs of goods or services provided to other State Agencies by Internal Service funds.
- *Incident* -- a transactional classification used to track costs associated with a particular event or activity, such as a hurricane or tornado, as determined by the Statewide Financial Policy Group.
- *Project* -- an accumulation of costs for a definite period of time. Project is required for all federal grants and all construction projects. Within the Project module, the following chartfields are available:
 - *Class* – Class SUB used by DWD and FSSA on federal funds sent to outside subrecipients
- *Activity* -- Functional Activity ; Distributional Activity
 - *Functional Activity* -- assigned at the time the transaction is created to classify transactions for budgetary and/or reporting purposes. Activity RECIPNT used by most on funds sent to outside subrecipients.
 - *Distributional Activity* -- assigned in the Activity chartfield on the new transactional lines generated in the Project module when the original transaction undergoes Funds Distribution.
- *Source Type* -- provides State agencies with a chartfield to be utilized to meet their external and internal reporting needs not satisfied by the Activity chartfield.
 - *Functional Source* -- assigned at the time the transaction is created. The Functional Source Category chartfield provides State Agencies with a chartfield to be utilized to assist in properly recording time and labor in the Project Module.
 - *Functional Source SubCategory* -- assigned at the time the transaction is created. The Functional Source SubCategory chartfield provides State agencies with an additional chartfield to be utilized to assist in properly recording time and labor in the Project module in a lower level of detail than captured in the Functional Source Category.
 - *Distributional Source Category* -- assigned in the Source SubCategory chartfield on the new transactional lines generated in the Project module when the original transaction undergoes

Funds Distribution. The Distributional Source Category will allow agencies to capture a lower level of detail related to a funding source than the level captured in Source Category.

- *Analysis Type -- assigned to transactions within the Project module to communicate information related to the transaction such as the source of the transaction, what the transaction signifies and how the transaction should be treated within the system.*

1.3.2 ENCOMPASS Accounting Entries

The State of Indiana is taking measures to avoid accounting errors and reduce the risk of over/understating revenues and/or expenditures in the financial statements. In ENCOMPASS, accounting entries are created a number of different ways:

- **Subsystem** – *A process called Journal Generator retrieves accounting entries from subsystems (AP, AR, AM, etc) and creates Journal Entries that are processed and posted in General Ledger*
- **Interface** – *Files are generated in a third-party software and loaded into ENCOMPASS to create Journal Entries*
- **Online** – *Users manually enter and process Journal Entries on the pages provided in General Ledger.*
- **Spreadsheet Import** – *Files are created in a delivered tool that uses Excel. The files are loaded into ENCOMPASS and then can be accessed and processed the same as if they had been entered online.*

The source of the accounting entry should be considered if adjustments or corrections for reporting are needed. Typically, if an adjusting entry is needed to correct a transaction that was previously miscoded in a subsystem, the adjustment should be entered and generated from the subsystem..

1.3.3 Sharing of revenue or expenditure/expense on original entry

- *Receipts (ROC) and Payments (AP Voucher) can be recorded to multiple Business Units and/or Funds on the original AP transaction. This process eliminates the necessity for numerous journal entries and is preferred if BU information is available. (See chapters 4 – revenues and 6 – expenditures for additional information.*
- *Receipts are deposited with TOS by BU(1) on behalf of BU(2);*
 - *The Deposit transaction is initiated in ENCOMPASS by BU(1)*
 - *The Deposit line distribution can be coded to BU(2) revenue account*
- *A voucher is split for payment by more than one BU;*
 - *Voucher is initiated in the system by the recording BU;*
 - *Voucher line distributions can be coded to other Business Units, thereby assuring that the expense is made to the correct BU and Chartfield string.*

1.3.4 "After the fact" distribution of Expense/Revenue

As of July 1, 2010, Journal Vouchers (JV) in the AP module will no longer be used for adjustments to transactions originating in AP. All such adjustments should be made in the General Ledger (GL) module with a Journal Entry (JE). Detailed descriptions should be included in the entry with a reference to the original AP voucher.

AR "After the Fact" Corrections should be made as described in section 1.4 and in chapter 4, Accounting for Revenues

1.4 EXAMPLES

1.4.1 BU to BU "After the fact" Distribution of Expenditures

Example: BU 500 has paid a \$10,000 bill for a consulting service which was shared with BU 505; it was impossible to determine the share to be paid by BU505 prior to the payment of the invoice. The invoice was paid from agency 500, fund 11410, account 531010. It was later determined that BU505's share should be \$2,000, to be charged to fund 16640. The Interunit Journal Entry to charge \$2,000 to Agency 2 would be made as follows:

Agency (BU)	Fund	Account	DR (+)	CR (-)
00500	11410	531010		2,000
00505	16640	531010	2,000	

Long Description on Header tab: To allocate share of APV00054254 (IBM Consulting) to BU00505.

The system will balance this entry by Business Unit and Fund with an equivalent entry to Cash. Users should not enter the cash lines shown here.

00500	11410	111500	2.000	
00505	16640	111500		2,000

Note: All required chartfields, such as Department, Program, and Budget Ref. are not shown in these examples.

The expenditure for BU 500 has been reduced by \$2,000; the expenditure for BU 505 has been increased. After both agencies have approved the transaction, it would route to the AOS for approval and posting to the General Ledger

1.4.2 "After the fact" Allocation of Expense to Federal Project

Example: BU500 has purchased, and paid for from their general fund (11410), software costing \$15,000, using account 555553. Based on a grant from the federal government, 50% of the cost is reimbursable by the grant, which is accounted for in fund 62130, Project #500MED08.

If this information had been available at the time of payment, the allocation would have been made on the original voucher. Since it was not, and a change in the distribution of the amount will result, a JE in GL is utilized as illustrated:

BU	Fund	Account	Project	DR(+)	CR(-)
00500	11410	555553	N/A		7,500
00500	62130	555553	500MED08	7,500	

Long Description on Header tab: To allocate 50% share of APV00054255 (Oracle) to federal project.

Again, the system will balance this entry by Business Unit and Fund with an equivalent entry to Cash. Users should not enter the cash lines as shown here.

00500	62130	111500	500MED08		7,500
00500	11410	111500	N/A	7,500	

All required chartfields, such as Department, Program, and Budget Ref. are not shown in these examples.

Note: When the reimbursement is received from the federal government, the grant revenue is credited (-) to the Project through the accounting lines in AR, as this is additional cash received by the state.

1.4.3 Passing Federal Dollars to Sub-recipient – Sub-recipient is Another State Agency or Another Federal Program – “After the fact” Revenue Sharing

Example: Federal Program 1 has received \$1,000,000 from the related federal agency. The amount of \$500,000 is to be transferred to either another State BU or another federal program. The originating project ID must be used by the recipient agency/program in order to trace the federal dollars (change the BU only). Again, both agencies must approve the GL JE before it is routed to the AOS for posting.

Agency (BU)	Fund	Account	Project	DR(+)	CR(-)
00500	62130	441000	500MED08	500.000	
00498	62240	441000	498MED08		500,000

Long Description on Header tab: To move federal revenue from 00500 to 00498 as subrecipient project.

The system will balance this entry by Business Unit and Fund with an equivalent entry to Cash. Users should not enter the cash lines. All required chartfields, such as Department, Program, and Budget Ref. are not shown in these examples.

00500	62130	111500	500MED08		500.000
00498	62240	111500	498MED08	500,000	

Note: With all of the above transactions, we have simply moved the revenue/expenditure from one fund/account to another. We have not increased (or decreased) the total revenue/expenditures of the state.

1.4.4 Payments to Fiduciary Funds/Quasi-Agencies/Component Units from Governmental Funds

State of Indiana Fiduciary Funds include PERF, TRF, State Police Pension, Child Support Fund and various payroll related funds. Quasi Agencies/Component Units include PERF, TRF, BMVC, IEDC IFA, IN Bond Bank, and State Lottery Commission.

A payment to these units is an expenditure of the state and revenue to the fiduciary or quasi unit and should be processed through Accounts Payable with a Voucher, just like any other payment to an outside vendor. Likewise, a payment from a fiduciary or quasi would be an expense of the fiduciary/quasi and revenue to the state and should be processed through an ROC with the Treasurer's Office.

1.4.5 Memo of Understanding (MOU) Between Agencies

A Memo of Understanding (MOU) may be created and approved by the State Budget Agency, as allowed by Financial Management Circular #2007-6, for the purpose of two or more State agencies to share goods or services.

Example: BU 080 has an approved MOU with BU 050 to provide certain audit services not otherwise required by law. In accordance with the MOU, salaries of auditors for time spent on this project totaled \$5,000. Keeping in mind that we do not want to overstate revenues or expenditures for the state as a whole, the following accounting entries could be made on a Journal Entry to the GL

BU	Fund	Account	Department	DR(+)	CR(-)
080	10750	511002	11000		\$5,000
050	10470	511002	11000	5,000	

The system will balance this entry by Business Unit and Fund with an equivalent entry to Cash. Users should not enter the cash lines. All required chartfields, such as Department, Program, and Budget Ref. are not shown in these examples.

1.4.6 Allocation of Expenditure/Expense

The most common use of the allocation is allocation of payroll expense to funds/projects other than the original payroll posting, which is automatically posted from the GEAC payroll system to the ENCOMPASS General Ledger. Universal use of ENCOMPASS Time and Labor eventually will eliminate the necessity for these allocations.

The original transaction in ENCOMPASS is made to the GL; the allocation will be made also as a GL Journal Entry, by reducing the expense (CR -) in the original fund, department, and other chartfields (if applicable), and increasing the expense (DR +) in the correct chartfields. This is similar to the process in effect prior to ENCOMPASS.

The system will balance this entry by Business Unit and Fund with an equivalent entry to Cash. Users should not enter the cash lines.

1.4.7 Allocation of Prior Year Expenses

Whenever possible, allocations should be processed in the year affected. However, allocations for some expenditures which occur late in the fiscal year may not be easily identified until after the fiscal

year (including budget year) have been closed. After this budget close, adjustments cannot be made to the prior year. Hence, such allocations must be made in the current year.

Example: BU 510 has payroll allocations from June 2010 to move certain payroll expenditures to other funds and projects.

The Journal Entry would be made as follows:

Agency (BU)	Fund	Account	Project	DR (+)	CR (-)
00510	15950	510100			7,500
00510	62410	510100	510UI650	7,500	

Long Description on Header tab: To allocate payroll to federal project

Note: All required chartfields, such as Department, Program, and Budget Ref. are not shown in these examples.

1.4.8 Passing Federal Dollars to Outside Sub-recipient

Outside entity is a local unit of government, not-for-profit, or quasi-state agency. Transactions of this nature will be processed through Accounts Payable with a Voucher just like any other payment to an outside vendor.

*Example 1 -- BU 500 remits \$500,000 from a **reimbursable** federal grant to Good County; the distribution would be an expense of the grant project at the State level and revenue to the county.*

Grant revenue to the project is credited when the reimbursement is received from the federal government.

Distribution to outside unit:

Agency	Fund	Account	Project	DR(+)	CR(-)
00500	62130	580190	500MED08	500,000	

Receipt of federal reimbursement:

00500	62130	441000	500MED08		500,000
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*Example 2 – BU 500 remits \$500,000 from an **advance** federal grant to Good County; the distribution, also an advance, would be a prepaid expense (+) of the grant project at the State level and a revenue to the county. As expenses are accounted for, the prepaid amount would be moved to an expense (+).*

BU	Fund	Account	Project	DR(+)	CR(-)
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Advance to outside unit:

00500	62130	191000	500MED08	500,000	
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Movement of prepaid expense to expense:

00500	62130	580235	500MED08	500,000	
00500	62130	191000	500MED08		500,000

1.4.9 ID Bills for Products/Services Rendered

ID Bills should be used *ONLY* by certain Internal Service Funds (ISF) billing for products or services to another Business Unit. The approved Internal Service Funds include:

- PEN Products (Institutional Industries)
- Office of Information Technology (OIT) (Telecommunications and Data Processing)
- Fleet Management
- State Mailing
- Various self insurance funds (ISP Health Insurance, Employee Disability, Employee Health Insurance)
- Aviation (Operation /Maintenance of State Aircraft)
- State Personnel Department (HR services)
- State Budget (Accounting Centralization)

For most ISF's, ID Bills will be a Journal Entry, initiated and processed by the internal service fund, debiting (+) the expense account 65xxxx for the business unit being billed and crediting (-) the revenue account 64xxxx in the internal service fund. PEN Products is currently the only exception. PEN will use a process that includes ePro and Accounts Payable to settle their ID Bill charges with other agencies (See section 1.4.10 for more information about PEN Products procurement). Agencies receiving the benefit of goods or services from an ISF should submit the default Chartfields to each internal service fund provider for the charges they expect to incur. No Inter Unit approval is necessary. All ID bills will be routed directly to the AOS for approval and posting. If the business unit billed discovers an error or has a complaint, a grievance should be filed with the internal service fund.

1.4.10 PEN Products Purchases – State Printing

All purchases from PEN Products should be processed through ePro and paid through Accounts Payable. Accounts beginning with "6" will be used for these transactions. These accounts should be used for all ID bill transactions beginning with the requisition, PO, and through the ID bill. PEN will assist you with selection of the proper account.

Pitney Bowes manages all printing requisitions from state agencies. They either accept the job and bill the agency or bid it out to outside vendors. In the case of an outside vendor completing the print job, Pitney pays the vendor and then bills the agency.

1.4.11 Movement of State Funds to Federal Funds

State appropriations will initially be recorded in a state legal fund which is established by state statute. **Individual BUs will not process these transfer transactions; these will be processed by SBA staff.**

As the revenue must be shown in the State fund, rather than reducing revenue in that fund and adding to revenue in the federal fund, a transfer account is used. These accounts begin with '74'.

Example: BU500 is required to provide a state match in the amount of \$500,000 for a federal grant, which is accounted for in fund 62130, project #500MED08. Appropriations/allotments have been recorded in fund 11410; \$500,000 must be moved to the federal project. Using transfer in/out accounts, the amount is moved, retaining the original revenue in the state legal fund.

<i>BU</i>	<i>Fund</i>	<i>Account</i>	<i>Project</i>	<i>DR(+)</i>	<i>CR(-)</i>
00500	62130	740110	500MED08	500,000	
00500	11410	750115			500,000

The system will balance this entry by Business Unit and Fund with an equivalent entry to Cash. Users should not enter the cash lines. All required chartfields, such as Department, Program, and Budget Ref. are not shown in these examples.

00500	62130	111500	500MED08		\$500.000
00500	11410	111500	AUD	500,000	

1.4.12 AR – ROC and Chartfield Error Corrections

If, after a deposit or related chartfield entries are approved and posted, an error is discovered, either in the accounting entries or the total deposit, the correction should be made in Accounts Receivable. For detail on these entries, see Chapter 4, Accounting for Revenues.